

Message Text

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ACTION EA-10

INFO OCT-01 AF-06 ARA-06 ISO-00 AID-05 CIAE-00 COME-00

EB-07 FRB-03 INR-07 NSAE-00 TRSE-00 XMB-02 OPIC-03

SP-02 CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15

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R 120945Z MAR 75

FM AMCONSUL PORT MORESBY

TO SECSTATE WASHDC 358

INFO AMEMBASSY CANBERRA

AMEMBASSY TOKYO

AMEMBASSY SANTIAGO

AMEMBASSY LUSAKA

AMEMBASSY KINSHASA

AMEMBASSY LIMA

AMCONSUL SYDNEY

C O N F I D E N T I A L SECTION 1 OF 2 PORT MORESBY 0219

E.O. 11652: GDS

TAGS: EMIN, EIND, PP

SUBJECT: KENNECOTT NEGOTIATIONS INCH FORWARD

REF: PORT MORESBY 084

1. BEGIN SUMMARY: IN CONFIDENTIAL INTERVIEW WITH CONGEN E/C OFFICER, KEITH HULLEY, MANAGER DIRECTOR OF KENNECOTT PNG LTD. AND ITS CHIEF NEGOTIATOR ON THE OK TEDI COPPER PROJECT, STATED THAT MAJOR IMPEDEMENTS TO AN AGREEMENT WERE: (1) THE QUESTION OF A FAIR RATE OF RETURN ON INVESTMENT; AND (2) THE PROBLEM OF INTERNATIONAL ARBITRATION IN CASE OF NATIONALIZATION. BOTH SIDES ARE MOVING SOMEWHAT CLOSER, BUT THE GPNG CONTINUES TO BATTLE STIFFLY AND ADROITLY FOR ITS POSITION WHILE KENNECOTT CONSIDERS ITS NEGOTIATIONS BOTH IN PNG AND IN AN INTERNATIONAL
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CONTEXT. ACCORDING TO HULLEY, THE NEXT WEEK IN THE NEGOTIATIONS

WILL BE CRITICAL. END SUMMARY.

2. KENNECOTT COPPER HAS SPENT ALMOST US \$18 MILLION IN EXPLORING THE SIZE AND CONTENT OF THE COPPER DEPOSITS IN THE STAR MOUNTAINS OF PNG. THE OK TEDI PROJECT WILL COST APPROXIMATELY US \$400 MILLION WITH AN ORE BODY REPUTEDLY LESS RICH THAN THAT OF BOUGAINVILLE AND WITH PROVEN RESERVES LIMITING LARGE SCALE PRODUCTION TO APPROXIMATELY FIFTEEN YEARS. NEGOTIATIONS PRESENTLY UNDERWAY WILL DETERMINE WHETHER OR NOT KENNECOTT AGREES TO INVEST AN ADDITIONAL US \$4 MILLION FOR TWO MORE YEARS OF EXPLORATORY WORK. HULLEY INSISTS THAT THE ADDITIONAL EXPLORATION IS NECESSARY IF KENNECOTT IS TO SHOULDER THE COST OF PROVIDING THE INFRASTRUCTURE REQUIRED TO EXPLOIT THE COPPER DEPOSITS. INITIALLY, IT HAD HOPED TO HAVE THE GOVERNMENT PROVIDE THE INFRASTRUCTURE RUMOURED TO COST IN EXCESS OF US\$50 MILLION, BUT THE GPNG REJECTED THE IDEA INSISTING THAT LARGE SCALE INVESTMENT PROJECTS MUST PROVIDE THEIR OWN INFRASTRUCTURE. THUS KENNECOTT BELIEVES ADDITIONAL RESERVES MUST BE FOUND IF THE VENTURE IS TO PROVE SUFFICIENTLY PROFITABLE TO RISK THE CAPITAL REQUIRED FOR EXPLOITATION. THE ONGOING NEGOTIATIONS ARE TO DETERMINE TO BOTH SIDES WHETHER THERE IS ENOUGH ROOM FOR A FINAL AGREEMENT AND, IF NOT, KENNECOTT WILL CUT ITS LOSSES NOW.

3. NEGOTIATIONS HAVE BOGGED DOWN ON TWO MAJOR POINTS: ONE, GOVERNMENT OFFICIALS ARE SEEKING TO WHITTLE DOWN PROFITS TO APPROXIMATELY 15 PERCENT PER ANNUM. KENNECOTT WILL NOT NOW SETTLE FOR ANYTHING LESS THAN 20 PERCENT. HULLEY STATED THAT: "WE MUST HAVE SOME FLEXIBILITY. THE BOOM/BUST COPPER CYCLE MEANS THAT ONE YEAR WE WILL HAVE A 5 PERCENT PROFIT AND ANOTHER YEAR 30 PERCENT. THE GOVERNMENT BELIEVES IT SHOULD BE ABLE TO SCOOP OFF THE UPPER RANGE OF PROFITS, BUT REFUSES TO MAKE ALLOWANCES FOR A DOWNTURN IN COPPER PROFITS. WE HAVE TO PROTECT OUR STOCKHOLDERS AND, CONSEQUENTLY, ARE INSISTING ON A LARGER PROFIT MARGIN THAN THE GOVERNMENT PRESENTLY IS WILLING TO ACCEPT." THE SECOND PROBLEM IS ONE OF PRINCIPLE. THE SOMARE GOVERNMENT INSISTS ALL DISPUTES BETWEEN FOREIGN INVESTORS AND THE GPNG BE SETTLED WITHIN THE COURT SYSTEM OF PAPUA NEW GUINEA. KENNECOTT BELIEVES ACCEPTANCE OF THIS PRINCIPLE WILL HAVE TWO ADVERSE EFFECTS: FIRST, IT WILL CUT THE GROUND FROM UNDER ANY FUTURE INTERNATIONAL APPEAL SHOULD A RADICAL GOVERNMENT COME TO

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POWER HERE WHICH WOULD NOT HONOR THE FORMER GOVERNMENT'S AGREEMENTS. (THE BOUGAINVILLE RE-NEGOTIATIONS, ALTHOUGH CLEARLY UNDERSTANDABLE GIVEN THE EXTRAORDINARY "WINDFALL PROFITS" EARNED BY THE COMPANY THIS PAST YEAR, HAS GIVEN FUTURE INVESTORS CAUSE FOR REFLECTION, AND KENNECOTT, AT LEAST, WOULD LIKE NOT TO BE ANOTHER BOUGAINVILLE AT SOME LATER DATE.) THE SECOND ADVERSE EFFECT IS EQUALLY DISTURBING TO A MULTINATIONAL CORPORATION SUCH AS KENNECOTT: THAT IS, ACCEPTANCE OF A WAIVER OF INTER-

NATIONAL ARBITRATION WOULD HAVE A LONG RANGE, AND PERHAPS PROFOUNDLY NEGATIVE, IMPACT ON ITS OPERATIONS ELSEWHERE. KEITH HULLEY SAID, "WE COULD GO INTO CHILE TODAY ON PROJECTS RICHER THAN THE OK TEDI, BUT WE WILL NOT, NOR WILL OTHER REPUTABLE FIRMS UNTIL ADEQUATE INVESTMENT GUARANTEES EXIST." THUS KENNECOTT IS WILLING TO FOREGO SHORT-TERM ADVANTAGE FOR A SOLIDLY NEGOTIATED AGREEMENT WITH WHICH BOTH SIDES CAN LIVE FOR A GOOD MANY YEARS.

4. A THIRD PROBLEM IN THESE NEGOTIATIONS HAS BEEN THE CHANGE OF GOVERNMENT NEGOTIATORS. THE MINISTERS HAVE APPARENTLY DELIBERATELY ISOLATED THEMSELVES FROM THE NEGOTIATING PROCESS. THE LOWER RANKING NEGOTIATORS, WHO HAVE CHANGED DURING THE TALKS, REFER EVERYTHING BACK TO HIGHER OFFICIALS. MOREOVER, MOST APPEAR TO LACK A CLEAR UNDERSTANDING OF THE COMPLEXITIES INVOLVED IN CONTENTIOUS ISSUES. HULLEY SAID THAT MUCH OF HIS TIME WAS SPENT IN EDUCATING THE OTHER SIDE. FOR EXAMPLE, THE NATIONAL INVESTMENT AND DEVELOPMENT AUTHORITY (NIDA) HAS BEEN INDIRECTLY INVOLVED IN FURNISHING INFORMATION TO THE GOVERNMENT SIDE. AT ONE POINT NIDA CONTACTED THE CONGEN AND REQUESTED A DETAILED RUNDOWN OF U.S. CORPORATE TAXES FROM 1913 TO THE PRESENT. WITH THAT INFO IN HAND, IT SOUGHT TO NEGOTIATE HIGHER TAX LEVELS. AS HULLY STATED, "THE GOVERNMENT SIDE FORGOT THAT THE U.S. GIVES CERTAIN ACCELERATED TAX WRITEOFFS AND DEPLETION ALLOWANCES WHICH MAKE A SIGNIFICANT DIFFERENCE IN THE PROFIT PICTURE." (ON THE OTHER HAND, KENNECOTT IS ASKING TO FREEZE CORPORATE TAXES FOR FIFTEEN YEARS AT THE 37.5 PERCENT LEVEL, SOMETHING THE GPNG IS UNWILLING TO CONSIDER.)

NOTE BY OC/T: REFTEL NUMBER BELIEVED TO BE INCORRECT.

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R 120945Z MAR 75
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TO SECSTATE WASHDC 359
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AMEMBASSY TOKYO
AMEMBASSY SANTIAGO
AMEMBASSY LUSAKA
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AMEMBASSY LIMA
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C O N F I D E N T I A L SECTION 2 OF 2 PORT MORESBY 0219

5. ANOTHER IMPORTANT, BUT LARGELY UNSPOKEN, FACTOR IN THE QUESTION OF PROFITS IS THE DESIRE OF MOST LARGE FOREIGN INVESTORS IN PNG TO AMORTIZE THEIR INVESTMENT OVER A VERY SHORT PERIOD. THUS AN UNOFFICIAL NORM APPEARS TO BE A FULL RETURN ON INVESTMENT FIVE TO SEVEN YEARS FROM START-UP DATE. HULLEY AND OTHERS ARE QUICK TO POINT TO THE FACT THAT PNG DURING THE YEAR AND A HALF OF SELF-GOVERNMENT HAS NOT DEVELOPED A TRADITION OF OPENNESS TO FOREIGN INVESTMENT WHICH IS WORRISOME. THE LOCAL NEWSPAPER REGULARLY CARRIES COMMENTS FROM MEMBERS OF THE HOUSE OF ASSEMBLY AND OTHER NOTABLES TO THE EFFECT THAT FOREIGN INVESTMENT IS RUINING THE COUNTRY AND THAT ITS IMPACT MUST BE SHARPLY RESTRICTED. CHIEF MINISTER MICHAEL SOMARE HIMSELF SEEKS THE FULLEST MEASURE OF POSSIBLE PROFIT FOR PNG. BUSINESSMEN HERE WOULD LIKE US TO BELIEVE THAT THEY ARE BEING CONFIDENTIAL

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SQUEEZED PRETTY TIGHTLY, AND WITH AN AS YET UNCERTAIN FUTURE, THEY CAN LOOK TO OTHER AREAS OF THE GLOBE FOR INVESTMENTS WHICH WILL BE AT LEAST EQUALLY AS SAFE AND CONSIDERABLY MORE PROFITABLE.

6. FINALLY, THE ISSUE OF POLLUTION LOOMS ON THE HORIZON. THE DANGERS ARE NOT MINIMAL SINCE THE ENTIRE FLY RIVER SYSTEM COULD BE SERIOUSLY POLLUTED AS WELL AS THE GULF OF PAPUA IF PROPER PROVISIONS ARE NOT TAKEN FROM THE BEGINNING. BOTH GOVERNMENT AND KENNECOTT ARE SENSITIVE TO THIS ISSUE, BUT CONSIDERABLE

WORK WILL NEED TO BE DONE TO BE SURE POLLUTION IN THE FLY DOES NOT REACH THE SERIOUS PROPORTIONS IT HAS ASSUMED ON BOUGAINVILLE AT THE PANGUNA MINE.

7. SINCE THIS CONVERSATION IN LATE FEBRUARY WITH KEITH HULLEY, A NEW ROUND OF NEGOTIATIONS HAVE COMMENCED--PERHAPS THE DECISIVE ROUND. KENNECOTT WANTS AN AGREEMENT AND THE SOMARE GOVERNMENT DEFINITELY WOULD LIKE TO PUT ANOTHER INVESTMENT EGG IN ITS BASKET ALONGSIDE BOUGAINVILLE COPPER. BUT BOTH SIDES

HAVE TO EDGE MORE TOWARD A CENTER POSITION BEFORE A FINAL
AGREEMENT CAN BE CONCLUDED.
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NOTE BY OC/T: REFTTEL NUMBER BELIEVED TO BE INCORRECT.

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